

Report of the auditor-general to the Northern Cape Provincial Legislature and the council on Khai-Ma Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Khai-Ma Local Municipality set out on pages X to X, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Khai-Ma Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with Standards of Generally Recognised Accounting Practice (Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (DoRA).

Basis for qualified opinion

Property, plant and equipment

3. The municipality did not have adequate systems in place to account for community assets in terms *GRAP 17, Property, plant and equipment*. I was not able to determine the full extent of the misstatement to community assets stated at R10 754 560 (R8 384 834) in note 2 to the financial statements were necessary as it was impracticable to do so. Consequently depreciation and accumulated depreciation were misstated by an unknown amount. Additionally there is a consequential impact on the surplus and accumulated surplus for the period.

Receivables from exchange transactions

4. The municipality did not recognise the provision for impairment on receivables from exchange transactions in accordance with *GRAP 104, Financial instruments*. The provision for impairment was incorrectly recognised, as it did not consider all credit exposure. I was not able to determine the full extent of the misstatement to the impairment of receivables from exchange transactions stated at R39 647 520 (2017: R31 366 836) in note 7 to the financial statements as it was impracticable to do so. Additionally, there was an impact on the surplus for the period and accumulated surplus.

5. The municipality did not recognise all service charges that have accrued in accordance with GRAP 9, *Revenue from exchange transactions*. As the municipality did not maintain adequate and complete records of services rendered, I was unable to determine the full extent of the understatement of service charges for the current year as it was impracticable to do so. Consequently, trade receivables from exchange transactions and taxes were understated. Additionally, there was an impact on the surplus for the period and on the accumulated surplus.

Receivables from non-exchange transactions

6. The municipality did not recognise the provision for impairment on non – exchange receivables in accordance with GRAP 104, *Financial instruments*. The provision for impairment was incorrectly recognised, as it did not consider all credit exposure. I was not able to determine the full extent of the misstatement to the impairment of receivables from non - exchange transactions stated at R3 845 113 (2017: R2 098 038) in note 8 to the financial statements as it was impracticable to do so. Additionally, there was an impact on the surplus for the period and accumulated surplus

Current and non-current provisions

7. The municipality did not recognise the provision for rehabilitation of landfill sites in accordance with GRAP 19, *Provisions, contingent liabilities and contingent assets*. The methods and assumptions applied in the calculation of the provision for rehabilitation of landfill sites are not considered reasonable. I was not able to determine the full extent of the misstatement to provisions stated at R17 587 099 in note 11 to the financial statements as it was impracticable to do so. Additionally there is a consequential impact on the surplus and accumulated surplus for the period.

Inventory

8. I was unable to obtain sufficient appropriate audit evidence to confirm inventory, due to a lack in systems at the municipality to provide sufficient and appropriate audit evidence. I was unable to confirm this by alternative means. Consequently, I was unable to determine whether any adjustments to inventory stated at R1 339 531 in note 6 of the financial statements were necessary.

Expenditure

9. The municipality did not recognise all bulk purchases in terms of the nature of the transaction in accordance with GRAP 1, *Presentation of financial statements*. Consequently, bulk purchases are understated and water losses overstated by R3 196 540 (2017: R1 003 329). Additionally there is a consequential impact on the surplus and accumulated surplus for the period.

Context for the opinion

10. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
11. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the

ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

12. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty relating to financial sustainability

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.
14. The financial statements indicates that the municipality's current liabilities exceeded its current assets by R36 251 425(2017:R27 504 864) at year-end. This, in addition to the other matters mentioned in note 57 to the financial statements, confirms that material uncertainty exist over the municipality's ability to continue as a going concern.

Emphasis of matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

16. As disclosed in note 41 and 42 to the financial statements, the corresponding figures for 30 June 2017 have been restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Material underspending

17. As disclosed in note 48.1 to the financial statements, the municipality materially underspent the final operating expenditure budget by R2 336 497 on the corporate services vote and the final capital expenditure expenditure budget by R4 332 685 on the infrastructure development vote.

Irregular expenditure

18. As disclosed in note 48.3 to the financial statements, the municipality incurred irregular expenditure of R11 842 220 during the year under review mainly due to non-compliance with supply chain management requirements. In addition, the full extent of irregular expenditure is still in the process of being determined.

Other matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Unaudited supplementary schedules

21. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

22. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with Standards of GRAP and the requirements of the MFMA and DoRA, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
23. In preparing the financial statements, the accounting officer is responsible for assessing the Khai-Ma Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

24. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
25. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Performance information reporting

26. I was unable to audit the usefulness and reliability of the performance information, as the annual performance report of the municipality was not prepared as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) and section 121(3)(c) of the MFMA.

Report on the audit of compliance with legislation

Introduction and scope

27. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

28. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements and annual reports

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, revenue, expenditure, irregular expenditure and prior period error on creditors identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

30. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

31. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R1 657 840 as disclosed in note 48.2 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest on overdue accounts.

32. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R6 557 948 as disclosed in note 48.1 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending of the approved operational expenditure budget.

Revenue management

33. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

Asset management

34. An investment policy adopted by council was not in place, as required by section 13(2) of the MFMA and municipal investment regulation 3(1)(a).

Strategic planning and performance

35. The IDP did not reflect a financial plan, as required by sections 26 h of the MSA.

36. A performance management system was not established, as required by section 38(a) of the MSA.

Procurement and contract management

37. Sufficient appropriate audit evidence could not be obtained that a contract was awarded in accordance with the legislative requirements because of the weak internal control environment and poor record keeping.

38. Sufficient appropriate audit evidence could not be obtained that bid specifications were unbiased and allowed all potential suppliers to offer their goods or services, as required by

SCM regulation 27(2)(a). This non-compliance was identified in the procurement processes for the following key projects:

- Upgrading of internal water reticulation network in Pofadder.
- Professional services for upgrading of internal water reticulation network in Pofadder.
- Construction of Pofadder bulk water supply augmentation project phase 1.
- Supply and Delivery of electrical material.

39. The preference point system was not applied for some of the procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act. Similar non-compliance was also reported in the prior year.

40. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.

Human resource management

41. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the Municipal Systems Act.

42. I was unable to obtain sufficient appropriate audit evidence that municipal manager and senior managers signed performance agreements within the prescribed period, as required by section 57(2)(a) of the Municipal Systems Act.

Other information

43. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements and the auditor's report.

44. My opinion on the financial statements and compliance with legislation do not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.

45. In connection with our audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

46. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

47. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective

was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

48. The leadership did not develop a performance management system to report on service delivery. Leadership did not hold municipal staff accountable as the performance system was not implemented. The leadership did not ensure that the municipality complied with applicable legislation as material findings on compliance with legislation were raised in the year under review. The municipality's internal processes and systems did not prevent material non-compliance or irregular, unauthorised as well as fruitless and wasteful expenditure. The leadership compiled an action plan based on audit report findings; however, it did not adequately monitor the existing action plan to ensure that corrective action was taken when required and within the required time frames. This resulted in similar material findings recurring in the current financial year.
49. Material amendments had to be made to the financial statements as these were not accurate and complete. This is an indication of weaknesses in internal control with regard to the review process of the financial statements. Management did not regularly review and monitor their compliance with legislation and internally designed policies and procedures. As a result, we noted significant non-compliance issues that could have been prevented.
50. The municipality did establish an internal audit unit and an audit committee but the internal audit unit and the audit committee did not function effectively. The municipality conducted a risk assessment no review or monitoring of the risks identified, took place.

Auditor-General

Kimberley

30 November 2018



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development objectives and on the [municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Khai-Ma Local Municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.